WEEKLY ECONOMIC COMMENTARY

29 Apr 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Squeeze on household finances continues

The pressure on household finances remains significant. Although the Official Cash Rate has remained on hold, borrowers continue to roll on to higher interest rates. And while inflation is dropping back, we're still seeing large increases in prices, especially for necessities like housing. A key issue for households in the year ahead is that the heat is now coming out of the labour market. Employment growth has already slowed, and the coming year will see higher unemployment along with a downturn in wage growth. There will certainly be tough conditions for many families over the coming year, with household spending likely to be weak. However, for the economy overall the downturn is likely to be manageable, with debt levels remaining serviceable.

New Zealand household finances

	Mar-20	Dec-23	Change
Average household disposable incomes (quarterly)	$100,000	$118,000	18%
Average household debt level	$170,000	$195,000	15%
Household debt to disposable income (annual)	171%	166%	5%

	Pre-pandemic average	Post-pandemic low	Current
Average mortgage rate	5.6%	3.2%	6.0%
% of disposable income spent on debt servicing	17%	10%	17%

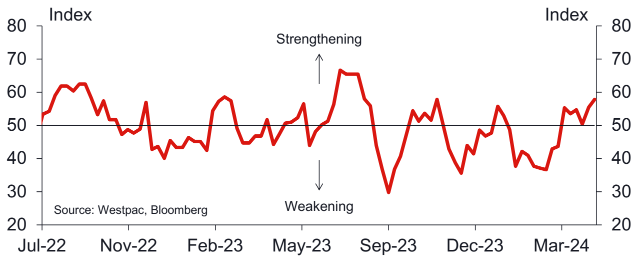
Source: Stats NZ, Westpac estimates

The latest update on New Zealand households' finances showed that, while the growth in debt levels has slowed, the average household is now carrying around 15% more debt than they did prior to the pandemic. However, while debt levels have increased in absolute terms in recent years, so did households' ability to service that debt.

Key views

	Last 3 months	Next 3 months	Next year
Global economy	→	→	↗
NZ economy	→	→	↗
Inflation	↘	↘	↓
2 year swap	↗	→	↘
10 year swap	↗	→	↘
NZD/USD	↘	↗	↗
NZD/AUD	↘	↗	↘

Westpac New Zealand Data Pulse Index



Key data and event outlook

Date	Event
1 May 24	NZ Labour market statistics, March quarter
1 May 24	RBNZ to release Financial Stability Report
1 May 24	FOMC Meeting (Announced 2 May NZT)
7 May 24	Govt financial statements for 9 mths to March
7 May 24	RBA Monetary Policy Decision and SMP
13 May 24	NZ Selected price indexes, April
22 May 24	RBNZ Monetary Policy Statement and OCR
30 May 24	Govt to release Budget 2024
5 Jun 24	Govt financial statements for 10 mths to April
14 Jun 24	NZ Selected price indexes, May
18 Jun 24	RBA Monetary Policy Decision
20 Jun 24	NZ GDP, March quarter
11 Jul 24	NZ Selected price indexes, June

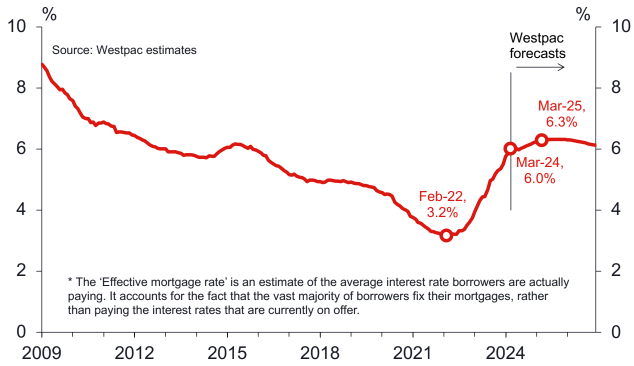
The low interest rates in recent years saw the share of household incomes being spent on debt servicing costs falling to low levels. At the same time, low interest rates also fuelled rapid GDP growth, along with strong growth in employment levels and earnings. Average disposable incomes have risen 18% since 2020. As a result, the level of household-debt-to-disposable-income has fallen from 173% in 2022 to 166% now. That's the lowest it's been since 2015. It's also well below the levels we saw during the 2008/09 financial crisis when many New Zealand households and businesses faced significant financial stress as economic activity turned down.

Household debt has been falling relative to disposable incomes

As interest rates have pushed higher since 2021, economic growth has stalled and the pressure on households' finances has mounted. Accounting for when households fixed their mortgages, the average mortgage rate that households are paying has already risen from a low of 3.2% in 2022 to 6% now.

Even though we don't expect any further OCR hikes from the RBNZ in the current cycle, there is still some modest further tightening in financial conditions to come as borrowers continued to roll off earlier low fixed rates. Those increases in borrowing costs will be much more modest than the very large increases that we saw over the past year, with the average mortgage rate expected to climb by a further 30 basis points over the next 12 months (around 90% of all mortgages in New Zealand are fixed for a period, and close to two-thirds will come up for repricing over the coming year).

Even with the RBNZ on hold, 'effective' average mortgage rate* to rise by around 30bps more



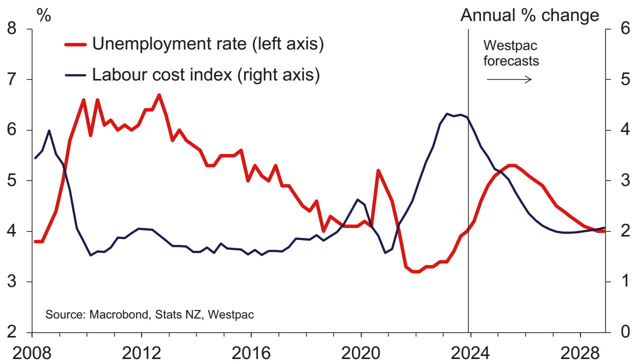
Recent years have also seen large increases in living costs more generally, with the Consumers Price Index rising by 20% since the start of 2020. That's eroded all households purchasing power. It's been particularly tough for those households on lower incomes as much of the rise in living costs relates to necessities, like housing rents (up 17% since 2020), food (up 23%) and utilities/property services (up 18%).

Key to how those tougher financial conditions will affect the economy more generally will be the strength of the labour market. At this stage, the labour market remains in good health, with unemployment still very low at just 4%.

However, the heat is coming out of the jobs market, with employment growth slowing below the rate of population growth in recent months. In our recent discussions with businesses across the country, many reported that they have scaled back their plans for hiring, and some have been shedding staff. Against that backdrop and with GDP growth set to remain moribund over the coming year, we expect this week's labour market figures will show that unemployment has already risen to 4.2% in the early part of 2024 (**as discussed in our preview here**). Furthermore, we expect that unemployment will rise to around 5% by the end of this year.

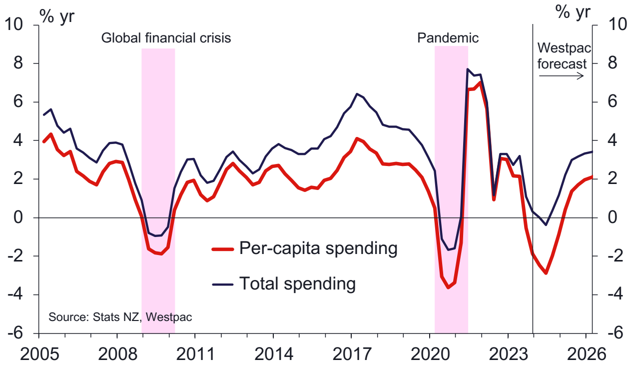
As the jobs market slows, wage growth is also likely to drop back. Consistent with that, businesses are already reporting some easing in wage pressures, along with a fall in staff turnover as workers have become increasingly concerned about job security.

Unemployment is low, but the labour market is softening and wage growth is slowing



With still strong financial pressures and a downturn in the labour market, many households have already put the brakes on their spending. In per capita terms, nominal spending levels have been flat for a year now. And adjusting for price changes, the amount of goods that New Zealand households have been taking home fell by 3% over the past year. With the labour market to weaken further, and consumers sentiment also likely to remain subdued, we expect continued weakness in household spending over the coming year, underpinning our forecasts for weak GDP growth over 2024.

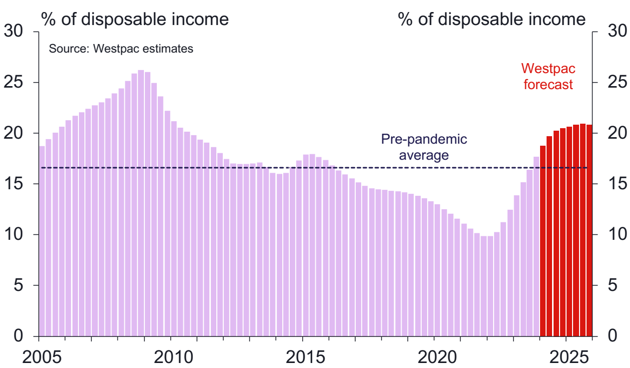
Per capita household spending has fallen, expected to remain weak over 2024



While the coming year will be challenging for many families, the downturn is likely to be manageable for the overall economy. The slowdown currently in train follows rapid growth in the wake of the pandemic that saw the economy becoming increasingly stretched, resulting in intense inflation pressures. We're now moving back into a position of better balance. Looking at the jobs market specifically, the expected rise in unemployment is from a very low level and it is expected to be a relatively modest slowdown compared to previous downturns (for instance, in the wake of the Global Financial Crisis unemployment peaked at 6.7%).

Crucially, the increase in households' debt servicing burden looks likely to remain manageable, even with the expected weakening in the labour market. While some borrowers have faced large increases in interest costs, the rise in the average mortgage rate has been from record low levels. As a share of households' disposable incomes, debt servicing costs are returning to around their pre-pandemic averages. In addition, savings rates have increased in recent years, which will help some households to smooth their spending.

Spending on interest costs has risen sharply from low levels, back around pre-pandemic averages (households with mortgages)



The implications for monetary policy and interest rates.

The relatively downbeat outlook for households and the labour market is a key plank in our view that interest rates will eventually fall early next year. But while the strength of the economy and household spending seems clear and likely sufficiently weak to eventually bring inflation pressures to heel in a timely fashion, thus far inflation pressures have remained strong in defiance of those drivers. Data from offshore in recent weeks show resurgent inflation pressures that have caused markets to reassess the path for rate cuts in key foreign jurisdictions. Indeed, the market is now flirting with the thought of interest rate hikes in Australia. This emphasises the message we have been sending for a while – that the path to 2% inflation is likely to be a long and bumpy one. The labour market and inflation data in coming months will likely be key for the path the RBNZ takes this year and next.

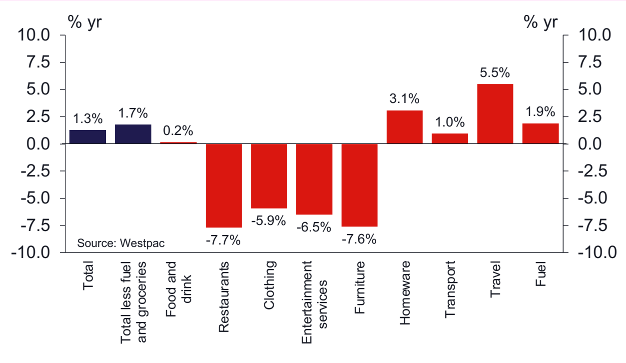
One area where these changed market views on the path for global interest rates has been felt is in the FX markets. The USD has been relatively strong and the Kiwi dollar correspondingly weak reflecting both the USD strength and the market's continued conviction that rate hikes won't come on to the table in New Zealand. Reflecting these trends we have adjusted our forecasts for the NZD over this year and revised the NZD down versus the USD and most cross rates. While New Zealand economic momentum looks weak and interest rate expectations contained, it seems likely the NZD will retain a weaker tone.

Satish Ranchhod, Senior Economist

Chart of the week.

New Zealand's retail sector has been looking very flat in the early part of the year. Our tracker of spending on Westpac issued debit and credit cards (full report available here) showed that spending levels in the three months to March were up just 1.3% on the same time last year. That's a slowdown from the already soft rates of growth that we've seen in recent months. It's especially notable given the strength in population growth. In fact, in most parts of the country spending growth has fallen below the rate of population growth, signalling outright falls in per capita spending levels. The weakness in spending reflects the continuing squeeze on households' finances, with high mortgage rates, as well as ongoing (and often large) increases in consumer prices. There's been particular weakness in spending on items like furnishings and apparel, as well as falls in spending in restaurants. We expect retail spending will remain under pressure over the year ahead.

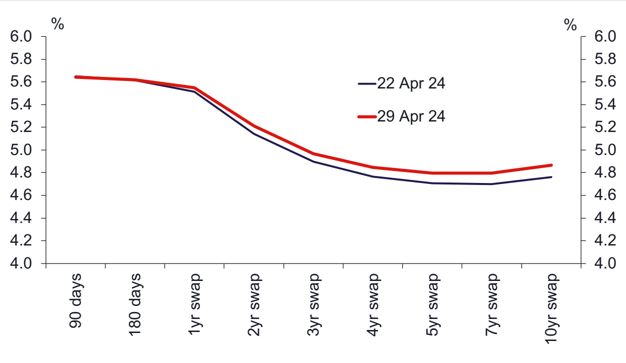
Spending appetites remain weak -annual spending growth (three months to March vs same time last year)



Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in April. While further OCR hikes don't look likely in the current cycle, easings are still some way off. For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

The US economy grew a disappointing 1.6%AR in Q1 – the slowest pace in almost two years. However, the core PCE deflator rose a firm 3.7%AR, likely undermining the Fed's confidence that annual inflation will soon settle at the 2% target. In other news, the flash composite PMI fell to a 4-month low of 50.9 in April. However, pending home sales lifted to a one-year high and initial jobless claims remained very low last week. This week a crowded US diary includes the Fed's policy meeting on Wednesday and the employment report on Friday. Given recent disappointing inflation readings, Chair Powell will likely indicate less deposition to ease policy settings in the near term. And should non-farm payrolls post another solid gain in April, this will increase the likelihood that the Fed will walk back its forecast of rate cuts when it next reviews it's projections in June. Other key data this week include the ISM manufacturing and services indexes for April and the Employment Cost Index for Q1.

Europe

The flash PMIs posted surprising declines in manufacturing activity in both the euro area and the UK in April. However, the ongoing trend improvement in the service sector boosted the composite PMIs to an 11-month high in both regions. National business surveys were a mixed bag, with headline confidence measures improving in Germany and the UK but falling in France and Italy. In the euro area the initial focus this week will be on Tuesday's flash Q1 GDP and April CPI reports, which seem likely to report modest growth in activity and a further decline in core inflation – outcomes that would likely leave the ECB on track to deliver a mid-year policy easing. Following Wednesday's May Day holiday, final April manufacturing PMI readings will be seen in both the euro area and the UK.

Asia-Pacific

Australia's CPI rose a higher than expected 1.0% in Q1. So while annual inflation declined to 3.6% – the lowest level since Q4 2021 – we now expect the RBA to begin an easing cycle in November, rather than September. This week most interest in Australia will centre on Tuesday's preliminary retail sales report for March, while trade and housing approvals data will follow later in the week. In Japan, the BoJ left its policy rate steady, while Governor Ueda downplayed worries about the impact on inflation of the weaker yen. This week, Japan will print its March IP, retail sales and labour market reports on Tuesday. Also on Tuesday, China will print its closely-watched official manufacturing and services PMI, together with the Caixin manufacturing PMI.

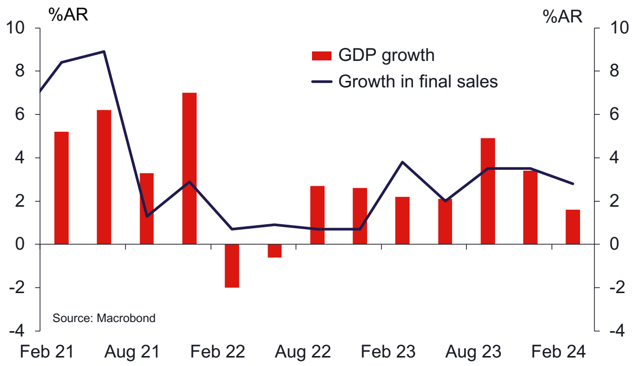
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.1	1.3	2.2
China	3.0	5.2	5.2	5.0
United States	2.1	2.5	2.6	1.4
Japan	1.0	2.0	0.7	1.0
East Asia ex China	4.5	3.4	4.1	4.2
India	7.2	7.7	6.5	6.5
Euro Zone	3.3	0.4	0.5	1.5
United Kingdom	4.1	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.4	3.4
World	3.5	3.3	3.3	3.1

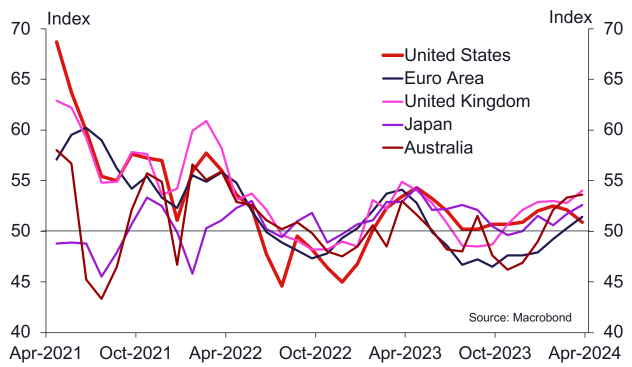
Australian & US interest rate outlook

	26-Apr	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.41	4.37	3.92	3.30
3 Year Swap	4.33	3.95	3.75	3.50
3 Year Bond	4.14	3.75	3.55	3.30
10 Year Bond	4.52	4.05	3.85	4.00
10 Year Spread to US (bps)	-17	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.69	4.00	3.80	4.00

US GDP growth



S&P Global composite PMI readings



Financial markets wrap

Interest rates.

NZ swap rates are likely to retain upward momentum near term as markets remain wary of the possibility that central banks in NZ and offshore may keep rates high for longer (or even raise them further, as they have priced in Australia). Inflation-related data will be the key to shifting this sentiment. The 2yr swap is near its six-month range high at around 5.20%, with potential for further gains to 5.25% during the weeks ahead.

Key events this week for the NZ rates markets will be the Q1 labour data on 1 May, the US payrolls data on 3 May, and the FOMC decision (likely a hold, but commentary will be of interest) on 1 May.

Market pricing for OCR cuts has been significantly pared over the past few weeks, with the first plausible month now seen as November. Our economists continue to forecast no cut until February 2025, noting core inflation remains sticky.

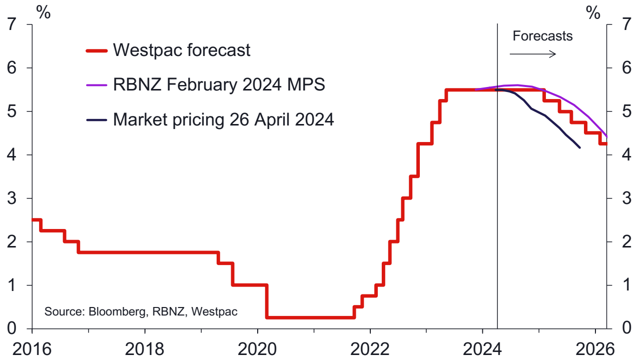
Foreign exchange.

The NZD/USD's rebound off 0.5850 has stalled in the mid-0.59s, and it looks neutral multi-day. The big events which could jostle it in either direction are the US jobs data and FOMC, and the NZ labour data (see above). The US dollar remains strong, backed by solid economic fundamentals and a rise in interest rates relative to other countries (as markets pared Fed rate cut pricing).

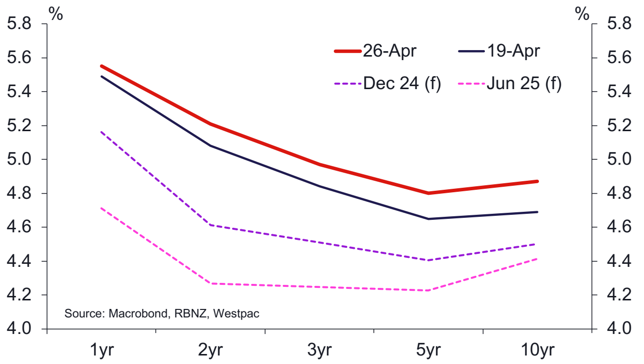
Looking further ahead, if our economists' forecasts for the Fed and RBNZ (easing to start in June 2024 and February 2025, respectively) prove correct, NZD/USD could rebound towards 0.6400 by year end. Alternatively, if the Fed were to defer its easing cycle, the NZD recovery would be smaller.

NZD/AUD broke down sharply over the past week and targets 0.9050 (the June 2023 low) during the week ahead, which will be on the radar of NZ exporters. AU inflation data was stronger than expected, and markets are now pricing some chance the RBA cash rate may need to rise further (which is not our forecast – we expect a rate cut in November).

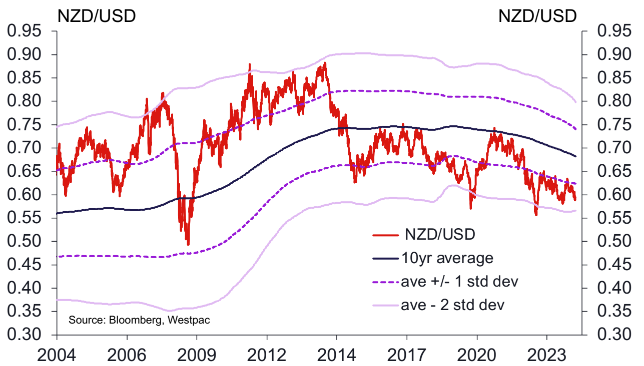
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.595	0.586-0.619	0.555-0.743	0.649	0.64
AUD	0.911	0.910-0.944	0.873-0.992	0.932	0.91
EUR	0.557	0.552-0.572	0.517-0.637	0.583	0.56
GBP	0.476	0.473-0.490	0.464-0.544	0.506	0.50
JPY	94.0	89.8-94.0	61.3-94.0	78.7	90.2

The week ahead

NZ Mar monthly employment indicator

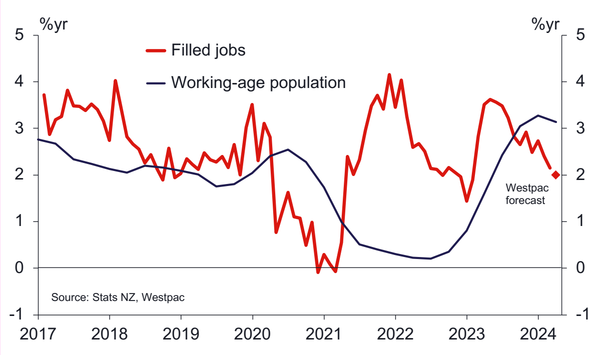
Apr 29, Last: +0.3%. Westpac f/c: +0.2%

The monthly employment indicator is drawn from income tax data, making it a comprehensive record of the number of people in work. While there are conceptual differences, it generally does a good job of predicting the more widely followed quarterly household survey measure of employment.

Job growth has slowed since mid-2023. While still growing, it has now fallen behind the pace of population growth, which continues to be boosted by record net inward migration. Surveys suggest that businesses are no longer struggling to find more workers, and job advertisements have fallen below pre-Covid levels.

The weekly data snapshots so far suggest another modest lift in jobs in March.

Monthly filled jobs growth



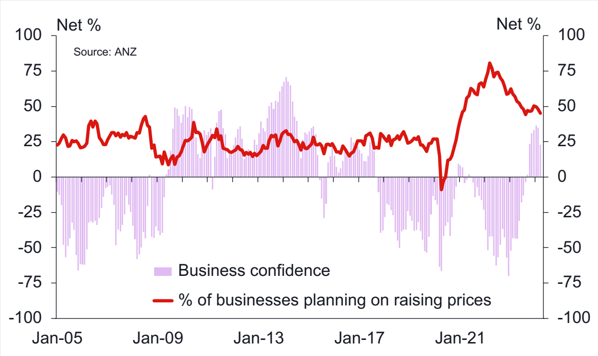
NZ Apr ANZ business confidence

Apr 30, Last: 22.9

After an initial burst of optimism at the end of last year (coinciding with the election of a centre-right government), business confidence has slipped back in the last two months as the reality of a slowing economy has set in again. In March a net 7% of businesses reported that their trading activity had declined over the past year, with particular weakness in the retail, construction and manufacturing sectors.

The survey's price and inflation gauges remain a key focus. Expectations of inflation for the year ahead fell to 3.8% in March, the lowest reading since October 2021. There was also an easing in the number of businesses expecting to raise their prices, though this remains high and had been rising again in previous months. We expect that most of the responses in the April survey will have pre-dated the March quarter CPI release, where the headline inflation rate fell from 4.7% to 4.0%.

Business confidence



NZ Q1 labour market surveys

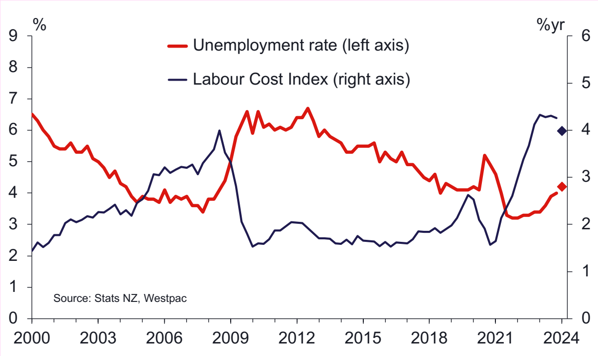
May 1, Unemployment rate Last: 4.0%, Westpac f/c: 4.2%
Labour Cost Index (all sectors) Last: 1.1%, Westpac f/c: 0.7%

We expect a further rise in the unemployment rate in the March quarter, from 4.0% to 4.2%. This would still be a low level by historical standards, but is a meaningful lift from the record low of 3.2% that was set two years ago.

Record net migration continues to drive strong population growth, providing a boost to both labour supply and demand. But at the same time, high interest rates are clearly weighing on activity. The net result is that employment is still rising modestly, but not fast enough to absorb the growth in the labour force.

Labour shortages have become far less prevalent over the last year, due to both the increased availability of migrant workers and the softening in the economy. We expect the pace of wage growth to have slowed in the March quarter, though remaining above what would be consistent with the RBNZ's 2% inflation target.

Labour market indicators



The week ahead

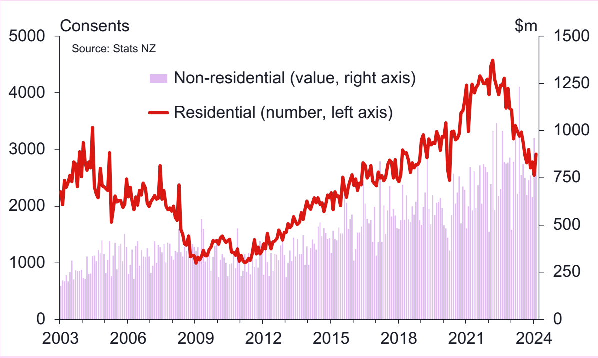
NZ Mar building consents

2 May, Last: +14.9%. Westpac f/c: -5%

February saw a bounce in residential consent issuance, with consent numbers rising 15%. However, that bounce in monthly consent numbers was centred on the volatile medium-density components and followed a particularly weak January result. The result took us back to trend, and that trend is firmly down.

We estimate that consents fell 5% in March, with some of February bounce in the more volatile consent categories likely to be reversed. In annual terms, we expect consent numbers to slip below 36,000 for the first time since 2019.

NZ building consents

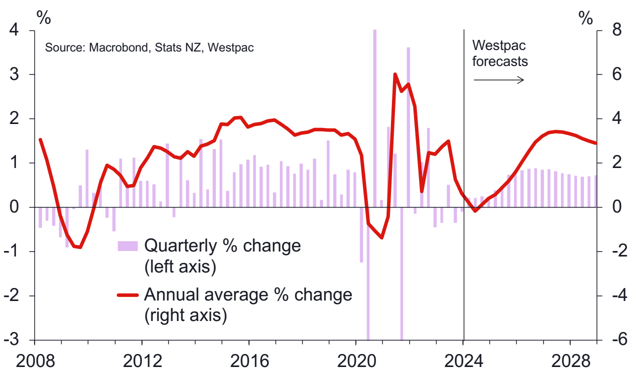


Economic and financial forecasts

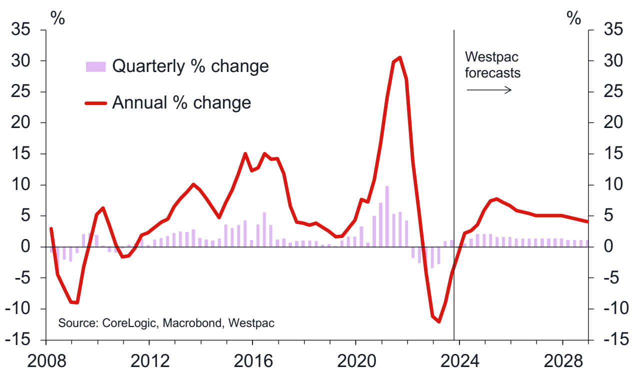
Economic indicators	Quarterly % change				Annual % change			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
GDP (production)	-0.1	0.2	0.2	0.2	2.4	0.6	0.4	1.6
Consumer price index	0.5	0.6	0.6	1.0	7.2	4.7	2.7	2.3
Employment change	0.4	0.1	0.1	0.0	1.7	2.4	0.3	1.0
Unemployment rate	4.0	4.2	4.6	4.9	3.4	4.0	5.1	5.2
Labour cost index (all sectors)	1.0	0.7	0.8	0.9	4.1	4.3	3.2	2.6
Current account balance (% of GDP)	-6.9	-6.3	-6.0	-5.5	-8.8	-6.9	-4.9	-3.9
Terms of trade	-7.8	6.4	2.7	1.5	-4.2	-10.6	12.0	3.4
House price index	-0.2	0.5	1.3	2.0	-11.2	-1.1	5.9	6.7

Financial forecasts	End of quarter				End of year			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.65	5.67	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.28	4.92	4.95	4.80	5.10	5.28	4.60	4.00
5 year swap	4.84	4.40	4.55	4.50	4.67	4.84	4.40	4.15
10 year bond	5.09	4.69	4.80	4.70	4.31	5.09	4.60	4.25
TWI	70.8	71.6	70.2	70.4	70.8	70.8	70.6	70.1
NZD/USD	0.60	0.61	0.61	0.62	0.60	0.60	0.63	0.65
NZD/AUD	0.93	0.93	0.90	0.90	0.92	0.93	0.90	0.89
NZD/EUR	0.56	0.56	0.55	0.55	0.59	0.56	0.55	0.56
NZD/GBP	0.49	0.48	0.48	0.48	0.51	0.49	0.49	0.50

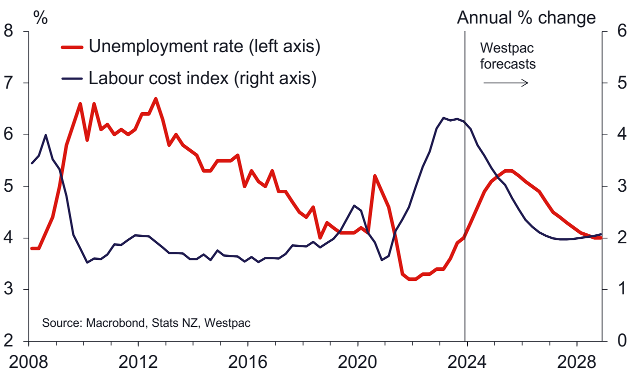
GDP growth



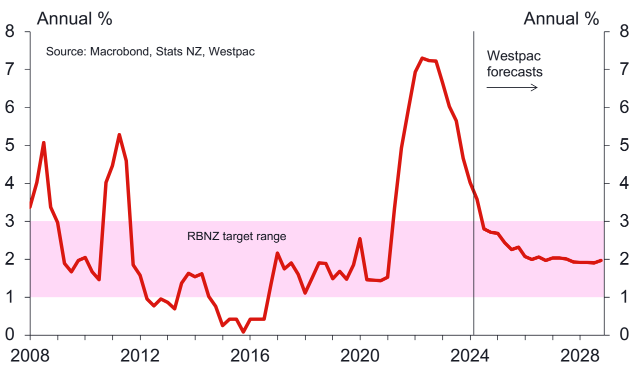
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
NZ	Mar employment indicator %mth	0.3%	–	0.2%	Jobs growth is now falling behind population growth.
Eur	Apr economic confidence	96.3	–	–	Eagerly awaiting rate hikes, consumers and business alike.
US	Apr Dallas Fed index	–14.4	–11.3	–	Outcomes are diverging across the regions.
Tue 30					
NZ	Apr ANZ business confidence	22.9	–	–	Activity gauges have eased. Pricing gauges down, but still firm.
Aus	Mar retail sales %mth	0.3%	0.2%	0.4%	Slight improvement in nominal sales in early 2024.
	Mar private sector credit %mth	0.5%	0.4%	0.4%	Slightly softer gain expected; in line with Oct-Dec outcomes.
Jpn	Mar jobless rate	2.6%	2.5%	–	Conditions remains tight and supportive for wages growth.
	Mar industrial production	–0.6%	3.3%	–	Weak quarter overall, consistent with underlying softening.
Chn	Apr NBS manufacturing PMI	50.8	50.3	–	Composition for manufacturing looking more constructive...
	Apr NBS non–manufacturing PMI	53.0	52.2	–	... the improvement in the employment sub-index being key...
	Apr Caixin manufacturing PMI	51.1	–	–	... to the outlook for households' confidence recovery.
Eur	Apr CPI %yr	2.4%	2.4%	–	Goods disinflation continues to do the heavy lifting.
	Q1 GDP %qtr	0.0%	0.2%	–	Economy stagnating under the weight of high rates.
US	Q1 employment cost index	0.9%	1.0%	0.9%	Labour income gains are easing, albeit very gradually.
	Feb S&P/CS home price index	0.1%	0.1%	–	Near-term momentum depends critically on turnover.
	Apr Chicago PMI	41.4	45.0	–	Proving to be a highly volatile indicator of late.
	Apr consumer confidence index	104.7	104.1	–	Highly sensitive to views on the employment outlook.
Wed 01					
NZ	Q1 employment %qtr	0.4%	0.3%	0.4%	Employment still on the rise despite the slowing economy...
	Q1 unemployment rate	4.0%	4.3%	4.2%	... but not enough to absorb the growth in the labour force.
	Q1 LCI wage inflation (pvte, ordry time)	1.0%	0.8%	0.7%	Wage pressures easing from their highs.
Aus	Apr CoreLogic home value index	0.6%	–	0.6%	Price gains continuing but now clearly a '2–speed' market.
US	Mar JOLTS job openings	8756k	8725k	–	Vacancies-to-unemployed not far off pre-pandemic levels.
	Apr ISM manufacturing	50.3	50.1	–	Employment sub-index points to downside risk for jobs.
	FOMC policy decision, midpoint	5.375%	5.375%	5.375%	Suite of quarterly activity and price data to inform guidance.
Thu 02					
NZ	Mar building permits	14.9%	–	–5.0%	Financial pressures and soft housing market remain a drag.
Aus	Mar goods trade balance $bn	7.3	7.4	7.4	Likely to remain little-changed following Feb narrowing.
	Mar dwelling approvals	–1.9%	3.0%	2.5%	Already weak but may be taking a new leg lower.
US	Mar trade balance $bn	–68.9	–69.0	–	External support to growth fades as deficit widens.
	Mar factory orders	1.4%	1.6%	–	March gain to round out an otherwise soft quarter.
	Initial jobless claims	207k	–	–	To remain at a relatively low level.
Fri 03					
Aus	Mar housing finance	1.5%	1.0%	4.0%	Established market relatively buoyant early in the year...
	Mar owner occupier finance	1.6%	–	3.8%	... construction–related activity also a touch firmer...
	Mar investor finance	1.2%	–	4.0%	... upgraders leading gains, investors poised to move later.
Eur	Mar unemployment rate	6.5%	–	–	Holding firmly at a historic low.
US	Apr non–farm payrolls	303k	250k	225k	Payrolls sees strength where other indicators do not...
	Apr unemployment rate	3.8%	3.8%	3.9%	... while April's update is unlikely to fully resolve this tension...
	Apr average hourly earnings %mth	0.3%	0.3%	0.3%	... it offers another chance to assess wages' downtrend...
	Apr ISM non–manufacturing	51.4	52.0	–	... and other indicators of employment's momentum.

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